Opening Statement of Damon Silvers
Congressional Oversight Panel
Learning from the Past: Lessons of the Bank Crises of the 20th Century
March 19, 2009

Let me begin by expressing my profound appreciation to the witnesses for joining us here today, and particularly to Mr. Lundgren for traveling from Sweden to be with us for this hearing. We are also honored by the presence of the His Excellency, Ambassador Hafstron. Recently, the Thomas Hoenig, the President of the Federal Reserve Bank of Kansas City, gave a speech in which he praised the work of Mr. Lundgren and his colleagues. This speech was called to my attention by Mr. Hoenig's Senator, Senator Brownback of Kansas, and I ask that it be entered into the record of this hearing.

In this Panel's first report, our very first question was, "what is Treasury's strategy?" I hope that this hearing and the further work of the Panel and its staff will enable us to better understand what Treasury's strategy is and how it measures up to the lessons of history.

In the written testimony we have received from today's witnesses, there are some distinct common points.

1. Financial crises tend to follow asset bubbles;
2. Financial institutions are reluctant to admit their true financial condition, and there is a tendency for regulators and other political bodies to indulge them in this wishful thinking;
3. Financial institutions with weak balance sheets contribute to a downward economic spiral by pulling back on lending activity;

The testimony suggests successful strategies for dealing with these common dynamics include:

1. Giving a government agency clear authority to restructure the banks
2. Being completely transparent about the strategy and operations of that agency;
3. Having that agency value bank assets on a realistic basis
4. Holding bank executives accountable for their mistakes
5. Being prepared to combine haircuts for bank investors with public funds to either (1) wind up truly failed institutions or (2) revive saveable institutions with adequate capital;
6. And above all, to move quickly to accomplish these tasks.

It is noteworthy that in the three successful examples we are considering today, in no case did effective action result from trying to keep shareholders of zombie banks alive, or from deferring to the incumbent management of those banks around key decisions such as asset valuation or executive pay.

On the positive side, the written testimony suggests that effective action often turns out to be less expensive than it appears at first, while delay in acting to restructure sick banks appears associated with increases in the ultimate costs to the public. This is a particularly striking feature of the testimony we have received on the most recent U.S experience of financial institution failure—the S&L bailout.

Of course, every country is unique. While we benefit from the dollar's status as reserve currency, on the other hand, we cannot rely on someone else's consumer demand to rescue us—as to some extent it seems both Japan and Sweden were able to rely on U.S. consumers to rescue them.

Ironically the United States has until very recently had a fairly decentralized banking system. But now our banking system looks more like Sweden's and Japan's than it does the U.S. system of the Depression era or even the late 1980's. And it seems that while we have many sick smaller banks, the FDIC is so far able to resolve them. It is the sick mega banks that are driving the crisis.

While this Panel is awaiting a more detailed statement of the new Administration's strategy, I believe the unstated strategy pursued by the Bush Administration in the four months following the passage of the Emergency Economic Stabilization Act of 2008 was essentially to offer a mix of implicit and explicit guarantees, backed up by equity infusions, in the hope of buying time for markets to become rational and bank balance sheets to recover. The fundamental assumption behind this strategy was that time was on our side.

This Panel has held field hearings in Nevada and in Prince Georges County, Maryland, where we have heard firsthand from homeowners and seen the assets underlying at least the first rounds of our financial crisis. I am convinced that the fundamental assumption of the Bush Administration's approach, that time was on our side, was mistaken, because the fall in asset prices at its heart was rational. Subprime loans and everything derivative upon them are not now and will never be worth their face value. The borrowers cannot pay their exploitative terms. The collateral is not worth and will never be worth on a present value basis anywhere near the value of the loans made on them.

The reality of these losses, combined with the dramatic concentration in the financial sector that has left us with 4 megabanks, is a profound procyclical force, deepening the recession and worsening the bank crisis. Spoonfeeding capital to broken institutions will not bring them back to life, nor will indulging in fantasies of reviving the real estate bubble. Having the government buy bad assets will either fully reveal the weakness of bank balance sheets, if done at fair prices, or if done at inflated prices will simply be a way of hiding the largest regressive wealth transfer in U.S. history—a wealth transfer that will still not be big enough to revive the biggest sick banks.

Most of all, the reality of losses and weak balance sheets is that time is not on our side, just as it was not the cure in any of the case studies we are looking at today.

The Obama Administration now faces the choice of continuing a failed strategy based on mistaken assumptions, or looking to the lessons of history to craft a new strategy consistent with the values of responsibility, transparency and shared sacrifice that President Obama has rightly asked our nation to embrace.

I look forward to hearing from our witnesses today on the lessons of history.